1955

Young Electric Sign Company v. State Tax Commission : Plaintiffs' Brief

Utah Supreme Court

IN THE SUPREME COURT OF THE STATE OF UTAH

YOUNG ELECTRIC SIGN COMPANY and YOUNG ELECTRIC SIGN COMPANY, INC.,

Plaintiffs,

— vs. —

STATE TAX COMMISSION,

Defendant.

Case No. 8383

PLAINTIFFS' BRIEF

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STATEMENT OF FACTS

On September 24, 1953, and September 25, 1953, the State Tax Commission mailed notices to the plaintiffs concerning the period from July 1, 1950, to June 30, 1953, and showing additional sales tax and interest due from the Young Electric Sign Company, in the amount of $3,029.91 and from Young Electric Sign Company, Inc., in the amount of $1,161.20 (R. 053 and 059). Within the time

prescribed by law the plaintiffs petitioned for a hearing and a correction of the amount of taxes assessed as aforesaid.

On November 13, 1953, the plaintiffs herein filed claims for refund of sales taxes claimed to have been erroneously and illegally assessed for the period from September 1, 1950, to October 31, 1953. On May 10, 1954, a formal hearing on the deficiency assessments and claims for refund was commenced. It was recessed after a short time and the balance of the evidence was adduced in the form of a Stipulation of Facts.

In its decision the Tax Commission did not refer to the claims for refund and in the record certified to this Court said claims were not included. The legal principles and questions involved in both the deficiency assessment and the claims for refund are the same, to-wit, to what portion of the plaintiffs' operation is sales tax applicable and how is it measured.

In its deficiency assessments the Tax Commission reconstructed sales tax returns for the plaintiffs as follows (R. 062 and 056):

1. By adding together the whole of the receipts from the following:

   a. Rental contracts,

   b. Options,

c. Sales,

d. Service and repairs.

2. By adding to those items the sum of the following purchases:

a. Materials used in yard, shop and office equipment (at cost).

b. Materials used on repair sales (at cost plus 100%).

3. By subtracting as non-taxable the whole of the receipts from the following:

a. Intercompany, interstate, exempt and wholesale sales,

b. Out of state contracts,

c. Service and repair sales,

d. Maintenance contracts.

These deficiency assessments calculated in this manner by the Sales Tax Commission were sustained by the Tax Commission pursuant to the hearing thereon (R. 005), but at the same time the Tax Commission, ordered that the deficiency be calculated differently (R. 005 par.'s 1. and 2.).

The following facts were stipulated to by the parties hereto (R. 069 and 075 inclusive):

1. The Young Electric Sign Company is a corporation organized under the laws of the State of Utah, on the 31st day of July, 1950, having its

principal place of business at 1148 South Second West, Salt Lake City, Utah, and the Young Electric Sign Company, Inc., is an Idaho corporation incorporated on the 27th day of March, 1950, and qualified to do business in the State of Utah on the 19th day of October, 1951, having its principal place of business at Ogden, Utah. The books and records of both companies are kept at the office of the Young Electric Sign Company and the method of accounting used for each corporation is the same.

2. The work of the Ogden corporation is so similar to the work of the Salt Lake corporation that cost ratios and percentages such as, for example, the ratio of the cost of labor and material to total amounts received pursuant to the rental agreements from the signs constructed by the use of that labor and material will be the same for both corporations. Unless otherwise specifically noted, the operation of the Ogden corporation is the same as the operation of the Salt Lake corporation. For the balance of this stipulation, the words "the company" shall apply to both corporations, except where otherwise stated.

3. The business of the company consists primarily of three functions, (1) the manufacture of electric signs and parts of signs, (2) the sale or rental of the same, and (3) the maintenance and repair of electric signs.

4. The income of the company is derived from the following types of transactions:

a. Outright sales of signs and sign parts manufactured by the company,

b. Repair sales,

c. Maintenance contracts,

d. Rental agreements.

5. *Outright sales* consist of the sale of signs and occasionally parts of signs, manufactured by the company. The price charged is what is called the "cash sale price" which is generally set by the company at twice the cost of labor and material going into the construction of the sign. Sales tax at the rate of 2% of the price charged (purchase price) is collected and remitted. Both parties concede that this is the proper measure of the sales tax on these transactions.

6. *Repair sales* are the billings for the repair, service and maintenance of signs owned by other persons and not subject to a "maintenance agreement." A customer calls in a request for service, the company's personnel and equipment go out and repair the sign, using what material is necessary, and the customer is invoiced for a lump sum charge. Labor and materials are not billed separately, but cost records are kept by the company. The cost of materials used in repair sales was a minor part of the total billings for repair sales for the period covered by the audit. It is agreed that the fair sales price of those materials is cost plus a 100% markup.

7. *Maintenance agreements* are executed on the form received in evidence as Exhibit "C" (R. 069). Under those agreements the company agrees to maintain and repair a sign owned by the customer for a fixed monthly fee payable for a fixed period, usually 36 months.

It is agreed that the proper measure of the tax to be charged for the materials used in maintaining and repairing signs under maintenance agreements should be the same as is charged for those materials used under "repair sales."

8. *Rental agreements* are contracts under which the company agrees to construct a given sign for the customer, install it on his premises, and maintain and repair it for the period of the agreement, and the customer agrees to pay therefor a fixed monthly charge. Exhibit "B" is the form of agreement used (R. 066). The income from rental contracts falls into the following types:

(a) Payments under original rental agreements.

(b) Re-writes, and

(c) Options.

9. When a customer approaches the company about a sign, or vice versa, the salesman and the artist discuss the requirements of the customer and the art department draws up a scale layout. Thereafter, the salesman fills out a "pitch sheet" (Exhibit "A") (R. 065) on which the sign is broken into its components, he prices the components from the price book, adds them up and ascertains the "cash sale price." This is the sum of the prices of components and is generally equal to twice the estimated cost of the labor and material in the sign. Generally speaking the cash sales price is not disclosed to the customer unless requested, but the monthly rental is calculated as indicated below and given to the customer.

10. The monthly charge is generally calculated by dividing the cash sales price by certain fixed numbers, according to the length of time involved, as follows:

(a) He divides by 10.9 to get the monthly charge for a 12 month period.

(b) He divides by 22 to get the monthly charge for a 36 month period.

(c) He divides by 27 to get the monthly charge for a 60 month period.

11. If the customer decides to rent the sign, he executes the form contract and the sign is manufactured and installed. The bulk of the rental contracts are for a 36 months period or a 60 months period.

12. If the customer, at the end of the original rental period, desires to continue to use the sign, a maintenance agreement is executed for a new term, on the basis of 50% of the original monthly charge. The agreements are on the same form as the original rentals and are termed "re-writes" on the books of the company.

13. Option income is that income received from signs held over after the expiration of the original rental agreement before the re-write is executed. The charge for the option period is, like the re-writes, 50% of the monthly charge set by the original rental agreement.

14. The income from re-writes for the period involved in the audit here in question is 37% of the total income from sign rentals. This percent-

age is calculated from the figures taken by the Tax Commission auditor from the original books of the company.

15. The purpose of the amount in excess of the cash sale price charged the customer over the rental period is to compensate the company for servicing and maintaining the sign during the period, which servicing and maintaining includes the furnishing of parts and materials which are not separately taxed. In the case of a 36 months contract, approximately 39% of the total rental charged is for service and maintenance, including parts and materials, and in the case of a 60 months contract, approximately 55% of the total rental parts and materials.

16. An analysis of the rentals contracted for during the entire period of this audit shows that the cash sales price was equal to 48.74% of the total amounts receivable for the signs to which said cash sales price applies. Or, stated conversely, the receipts for servicing and maintaining said signs, including parts and materials, during the period of the audit was 51.26% of the total amounts received from them during the original lease period.

17. During the re-write period, because of the increased age of the sign, the cost of maintaining the same is greater than the maintenance expense during the original rental period. The rental during that re-write period is for the purpose of compensating the company for maintaining and repairing the sign, which includes the parts and materials, together with a reasonable profit.

18. The entire cost of any signs placed with the customer under a rental agreement is amortized over the period of the original term of that agreement so that, at the expiration of the original lease period the sign is completely written off as an asset of the company. At that time the company eliminates from the contract price for the rental of the sign that portion of the rental which it attributed to recovering the cash sale price and re-writes the contract at a price approximately equal to what would be charged for the service and maintenance of the sign, were it the property of the customer.

19. The only tangible personal property which is involved in the rental agreements hereinabove referred to is the sign itself together with what materials and parts are used in the course of the servicing of the sign.

20. In the case of a rental contract no separation is made in the actual billing to the customer of the amount which is charged for the sign itself and of the amount which is charged for the service and maintenance; however, before said rental agreements are entered into the cash sale price of th sign is always calculated by the company to use in arriving at the rental price and is available and given to the customer on request. Some request the information, some do not and it is not generally given unless requested. The amount which is charged under the rental arrangements for the various periods can be calculated, but generally it is only calculated for the period or periods in which the customer indicates he is interested.

21. Wtih relatively few exceptions, each sign is custom designed for the particular needs of the particular customer and has no substantial value to anyone other than that customer or someone purchasing his business and name.

22. The salvage value of any given sign at any time after its construction is approximately equal to the cost of removing and disassembling the sign and, the cost to the company of removing, disassembling, remodeling and reassembling a given sign is greater than would be the cost of fabricating the sign from new material.

23. The useful life of any given sign, properly maintained and repaired, is substantially longer than the original rental period.

24. The price at which a given sign would be sold to a customer in an outright sale (i.e., its cash sale price) plus the cost of a 36 month maintenance contract is approximately equal to the total charge for the 36 month period as calculated in the manner set forth in paragraph 10 above.

25. In 1936 and 1938 the Utah State Tax Commission made and entered the decisions attached hereto and marked Exhibits 1 and 2. No appeal was taken from either decision. In 1937 the Utah State Tax Commission advised the partnership involved in the decisions attached to this stipulation, that it could avoid sales taxation of the total rental receipts if it would prepare separate contracts for the sale and the maintenance of such signs as are involved in the "rental agreements." At the time of the audits and assessments involved in this action, the auditor of the Utah

State Tax Commission advised the companies that they could avoid sales taxation on the total rental receipts by executing separate contracts for the sale and the maintenance of the signs concerned in the "rental agreements." Counsel for the State Tax Commission have subsequently reiterated that advice to counsel for the companies.

Of the total operation of the company, the service, maintenance and repair of signs preponderates (R. 019). The General Manager, Mr. Schutte, in his testimony described the service, maintenance and repair as the bulk of the operation (R. 019).

The report of the auditor for the Tax Commission relative to the Young Electric Sign Company shows the total repair sales for the period of the audit were $244,986.01 and that the cost of materials used in those repair sales was $14,698.75. This shows that the cost of materials used in repair sales was six per cent (6%) of the total charge for those sales in the Salt Lake operation. The Salt Lake plant made eighty-seven (87%) of the repair sales involved in this action.

In the stipulation of facts the Tax Commission stipulated that the proper measure of tax to be charged for materials used in maintaining and repairing signs under "maintenance contracts" should be the same as is charged for those materials used in "repair sales" (R. 071) and that materials were never billed separately from labor in repair sales (R. 070).

In its decision the Tax Commission applied three different measures to the "maintenance contract" and "repair sale" income (R. 005). It, in the same order, (1) affirmed and sustained the assessment as made by the auditor (R. 062 and 056) on the theory that materials used in repair sales should be taxed at two per cent of *fair sales price* (cost plus 100% markup), (2) ordered that the sales tax on parts and materials used in repair sales where no separate billing is made for materials should be two percent of the *total billing,* and, (3) ordered that materials used in repair and maintenance service furnished under "maintenance contracts" should be taxed at two per cent of the *cost* of those materials to the company.

In this brief, as in the Stipulation of Facts above, the plaintiffs will be referred to as "the company" and the defendant as the "Tax Commission." The Emergency Revenue Act of 1933 will be referred to as the "Sales Tax Act."

STATEMENT OF POINTS

POINT I

THE TAX COMMISSION ERRED IN HOLDING THE WHOLE RECEIPTS FROM THE RENTAL AGREEMENTS ON SIGNS DURING THE ORIGINAL PERIOD OF THE AGREEMENT TO BE SUBJECT TO SALES TAX BECAUSE 51.26% OF THOSE RECEIPTS RESULT FROM CHARGES MADE FOR NON-TAXABLE MAINTENANCE AND REPAIR SERVICE.

POINT II

THE TAX COMMISSION ERRED IN HOLDING THE RECEIPTS FROM "OPTIONS" AND "RE-WRITES" TO BE SUBJECT TO SALES TAX BECAUSE THOSE RECEIPTS ARE FROM THE SALE OF NON-TAXABLE MAINTENANCE AND REPAIR SERVICE, AND THE TAX COMMISSION HAS STIPULATED THAT THIS IS THE PURPOSE OF THOSE CHARGES.

POINT III

THE TAX COMMISSION ERRED IN HOLDING THE RECEIPTS FROM "MAINTENANCE CONTRACTS" AND FROM "REPAIR SALES" TO BE SUBJECT TO DIFFERENT MEASURES OF SALES TAX BECAUSE THE TRANSACTIONS ARE EXACTLY THE SAME IN EVERY PERTINENT RESPECT AND THE TAX COMMISSION STIPULATED THAT THEY SHOULD BE TAXED THE SAME.

POINT IV

MATERIALS USED BY THE COMPANY IN "REPAIR SALES" SHOULD BE TAXED AT THE RATE OF TWO PER CENT OF THE COST OF THOSE MATERIALS TO THE COMPANY AS WAS DONE WITH MATERIALS USED IN "MAINTENANCE CONTRACTS."

POINT V

THE TAX COMMISSION ERRED IN HOLDING THE WHOLE RECEIPTS FROM "REPAIR SALES" TO BE SUBJECT TO SALES TAX UNLESS THE MATERIALS ARE BILLED SEPARATELY, BECAUSE THERE IS NO AUTHORITY IN THE SALES TAX ACT FOR THE TAXING OF MAINTENANCE AND REPAIR SERVICE AND THE TAX COMMISSION CANNOT, BY REGULATION, RENDER THAT

TAXABLE WHICH THE LEGISLATURE HAS NOT SUBJECTED TO TAX.

POINT VI

WHETHER A GIVEN SALE IS SUBJECT TO SALES TAX IN UTAH SHOULD BE DETERMINED BY THE SUBSTANCE OF THE SALE, NOT BY ITS FORM OR MANNER OF BILLING.

POINT VII

TAXING STATUTES ARE TO BE STRICTLY CONSTRUED, AND, IN CASES OF DOUBT, ARE TO BE CONSTRUED MOST STRONGLY AGAINST THE GOVERNMENT AND IN FAVOR OF THE TAXPAYER.

ARGUMENT

PRELIMINARY STATEMENT

The company is engaged in two main activities, (1) the manufacture of electric signs, and (2) the electric sign service and repair business. The bulk of the business is in service and repair. Normally there wouldn't be much of a sales tax problem in the manufacturing end of such an operation because one who sells a manufactured item at retail must collect 2% sales tax on that sale. But a large part of the business of the company is done under an arrangement that intermingles its two activities and calls the receipts from both "rentals." This is done for business reasons, the wisdom of which is affirmed by the steady growth of the company.

Not only are the "sale" and "repair" functions combined in one charge called a "rental," but, as a further complication, at the end of the first rental period (usually three or five years) when the company considers the customer to have paid for the sign, they just rewrite the rental agreement and cut the charge 50% so that the whole charge under this re-write is for "maintenance and repair," just as is the case under a regular long term "maintenance contract." This reduced charge is still denominated a "rental" and is made under exactly the same contract as was first used.

The principal issue in this case is how those "rentals" should be taxed under the Sales Tax Act. Under this issue there are two classes of transactions involved, first, the original rental agreement and, second, the options and rewrites.

The company says that you should look behind the "rental agreement" and see what part of the charge is made in lieu of the "sale" of the manufactured sign, i.e., what part of the charge is for the sign itself and its possession and use, and what part of the charge is made for "maintenance and repair" of the sign for the three to five year period of the "rental agreement." This can be ascertained from the books and records of the company. It was done in this case and the results put in the Stipulation of Facts.

The Tax Commission says you can't look behind the rental agreement, that if you call the proceeds of

it a "rental," the whole of it is thereupon taxable, regardless of what the "rental" is in lieu of. They draw this conclusion from the statute which says "and the tax shall be computed and paid by the vendor upon the rentals paid." (Sec. 59-15-2 (g) U.C.A. 1953).

The second main issue in this case concerns the measure of sales tax resulting from the "service and repair" part of the business, where there is no "rental" factor involved whatever. As stipulated, this is done under two arrangements, (1) what is entitled "Sign and Lightning Maintenance Agreement," and (2) separate individual orders for service, billed as the job is done. Under the first of these, the company says "We'll do all the service on your sign for three years for X dollars a month, and we'll take the risk of any extraordinary expense," under the second, the customer takes the risk of extraordinary expense and just pays for the repair work as he orders it. In both instances the work done is the same and is done in the same manner, the ony difference is how it is billed.

The heart of the plaintiffs' case is their claim that the Tax Commission while giving lip service to the rule that service is not subject to sales tax, has gone ahead and taxed service (1) wherever it was mixed half and half with a taxable rental, (2) wherever it was called a "rental", and (3) where it was mixed with the sale of any repair material. The plaintiffs find no authority in the law for the Tax Commision to do this.

The plaintiffs arguments are based on four major premises underlying the Points set forth herein:

1. That the Sales Tax Act does not tax the sale of maintenance and repair services.

2. That calling the sale of maintenance and repair service a "rental" does not make it subject to sales tax.

3. That failure to separate the charge for materials from the charge for maintenance and repair service in billing does not render the sale of maintenance and repair service taxable.

4. That where cost of materials in a repair service is only 6% of the sale price it is merely incidental and the repair service sale is not a "retail sale of tangible personal property." The repairman would have to pay the sales tax when he purchased the materials.

POINT I

THE TAX COMMISSION ERRED IN HOLDING THE WHOLE RECEIPTS FROM THE RENTAL AGREEMENTS ON SIGNS DURING THE ORIGINAL PERIOD OF THE AGREEMENT TO BE SUBJECT TO SALES TAX BECAUSE 51.26% OF THOSE RECEIPTS RESULT FROM CHARGES MADE FOR NON-TAXABLE MAINTENANCE AND REPAIR SERVICE.

The first question that arises under this Point is whether or not charges made for maintenance and repair service are, in fact, subject to sales tax.

1. *The Sales Tax Act does not purport to impose a tax on the sale of services.*

This proposition may seem so elementary that it wouldn't even be controverted, but, in fact, it is the heart of this action. The Tax Commission has assessed a tax on "services" where they are included with rentals and where they are included with repairs, and the plaintiffs just don't think services are subject to sales tax.

The *Legislature* has said that sales tax only applies to the sale of tangible personal property as follows:

> "59-15-4. Excise Tax - Rate. * * *
>
> (a) A tax upon every retail sale of tangible personal property made within the state of Utah equivalent to two per cent of the purchase price paid or charged, * * *"

The *Supreme Court of Utah* has pointed up that this is the purpose of the Sales Tax Act in *Utah Concrete Products Corp.* vs. *State Tax Commission,* 101 U. 513, 125 P. (2d) 408, as follows:

> "* * * we find its declared purpose to be a 'tax upon every retail sale of tangible personal property made within the state of Utah equivalent to two (2) per cent of the purchase price paid or charged * * *".

The *State Tax Commission of Utah* in its biennial reports to the Governor and to the Legislature has stated

clearly the purpose of the Act. In the Second Biennial Report of the State Commission of Utah at page 26 the purpose was stated as follows:

> "The tax is different from the sales taxes in most of the twenty-five or twenty-six states where sales taxes are now in force in one form or another in that it is specifically a tax on the transaction, the sale of goods, whereas in most other states the tax is a license imposed upon the seller for the privilege of engaging in the business of selling or a tax upon the gross receipts of the seller. * * *

In the Fourth Biennial Report of the State Tax Commission of Utah at page 33 the purposes were set forth as follows:

> "The Emergency Revenue Act, better known as the 'Sales Tax Act' has been in effect in this state since June 1, 1933. This Act imposes a two per cent tax on retail sales of tangible personal property, certain service rendered by public utilities, sales of meals, and the amount paid for admission to a place of amusement or recreation. * * *"

In the Fifth Biennial Report covering the period from July 1, 1938, to June 30, 1940, the State Tax Commission, at page 96, recommended that the Legislature expand the scope of the Sales Tax Act so as to include services in certain instances. The exact recommendation is as follows:

> "There are several types of transactions wherein labor or services is sold in connection with the sale of tangible personal property. An illustration of this would be the sale and making of drapes when the purchaser would buy the materials and then have the same tailored or fabricated as to size and pattern. We believe it is desirable that the law be changed so as to require tax to be paid upon the charge made for such services and thus the base of the tax would be the fair value of the finished article."

This recommendation was not followed by the Legislature and no change was made in the Sales Tax Act so as to provide for the taxation of services. The recommendation was not reiterated by the State Tax Commission in any of its subsequent reports, so they must be presumed to have acquiesced in the Legislature's refusal to tax services. That they did so acquiesce is shown in the Seventh Biennial Report of the State Tax Commission on page 60 where they say to the Legislature:

> "From the administrative point of view this commission finds the present laws are reasonably satisfactory. * * *"

2. *The Tax Commission has admitted that charges for maintenance and repair service are not subject to sales tax in Utah.*

a. In paragraph 25 of the stipulation of facts (see page 10 of this brief) the Tax Commission points up that it believes and has advised the predecessors of the plaintiff herein, and these plaintiffs, that if they

will use two contracts, a contract of sale (or, presumably "rental") and a contract of maintenance, separating in its contracts and its billing to the customer the charges for the sign from the charges for maintaining it, the charges for the contract of maintenance would not be subject to tax. *This necessarily implies that charges made for servicing and maintaining electric signs are not subject to sales tax.* It is true that the company must pay sales tax on the material used in connection with those services when it purchases those materials or supplies, or, if it makes the purchases under a resale certificate, must report and pay the tax on its own return.

b. In *Sales Tax Regulation* 59 relative to repairmen, the Tax Commission states that if the charge for materials is stated separately from the charge for repair service, only the sale of the materials is taxable. This necessarily assumes repair service to be non-taxable.

c. In *Sales Tax Regulation* 64 relative to Morticians, Undertakers, and Funeral Directors, the Tax Commission recognizes that, although, for business reasons, undertakers, etc., do not bill their charges for tangible personal property such as caskets, embalming fluids, etc., separately from the charges for their services (in fact they include the whole thing in what purports to be a bill just for the casket), the charge for services is not subject to sales tax. This result is similar to what the plaintiff seeks to have done in relation to its business where, instead of a bill called "price of casket", the bill is called "rental of sign". Both billings embody a mix-

ture of charges half for personal property and half for service.

Regulation 64 reads as follows:

> "*Morticians, undertakers and funeral directors.* — Morticians, undertakers and funeral directors sell tangible personal property for use or consumption. They also render services to their patrons for which they make a charge. Their sales of tangible personal property, such as caskets, vaults, clothing, flowers, etc., are subject to tax. They, in turn, use antiseptics, cosmetics, embalming fluids, and other chemicals, in rendering professional services and their purchase of the same is a sale to the user or consumer and is taxable.
>
> If the books are kept in such a manner as to reflect the sales of tangible personal property as a separate item and the services rendered as a separate item, then the tax attaches only to the sale of tangible personal property.
>
> If no separation is made of the tangible personal property and the services rendered, the sales tax is collected upon one-half of the lump sum price quoted for a standard funeral service, which includes the furnishing of a casket, professional services, care of remains, funeral coach, floral car, use of funeral car, use of funeral chapel, and the securing of permits. Clothing, outside grave vault (a concrete or metal box into which the casket is placed), and other tangible personal property furnished in addition to the casket must be billed separately and the sales tax collected thereon.

d. *Sales Tax Regulation* 69 relates to another case where services are not billed separately from the charge for the personal property, but services make up a substantial portion of the charge. Tire re-cappers pay sales tax on only one-half the amount that is billed as "sale of re-capped tire". The Regulation applicable to them reads:

> "*Recapping and repairing of tires.* — Persons recapping and repairing tires are retailers of the tangible personal property furnished in connection with the repair work and must report and pay tax upon the sale of such property.
>
> Records should be maintained in such a manner as to reflect the amount of the sale of the tangible personal property separate from the services. If no separation is made of the tangible personal property and the services rendered, it shall be deemed that one-half the lump sum price charged or collected for recapping of tires and/or vulcanized tire repairs is the sales price of the tangible personal property sold and the sales tax must be collected upon this basis.

In both the mortician and the tire-re-capper cases, if the books show what portion of the charge is for the tangible personal property, that amount is the base for measuring the tax. In the instant case, the books of the plaintiff companies show, and it is stipulated, that the charge made for the transfer of the tangible personal property is 48.74% of the total charges during the original lease period. This portion of the "rental" is analagous to the "sale of goods" portion of the Mortician

and tire re-capper transaction and should be the basis for sales tax on "payments under original rental agreements."

All that the plaintiffs herein are asking for is treatment equal to the other businesses which furnish mixed services and property in about equal shares under a single billing. In view of the fact that the morticians bill for their services under the term "casket price" and the tire re-cappers under the term "tire price", the fact that the plaintiffs herein bill for their services under the term "sign rental" should not cause those services to become subject to sales tax.

These regulations are administrative recognition of cases from other jurisdictions specifically holding that services were not taxable under the Sales Tax Act and that failure to bill them separately from materials did not make them taxable. See the following cases:

Commission v. Dinnien (1936) 320 Pa. 257, 182 A. 542;

Kirstner v. *Iowa St. Bd. of Assessment and Review* (1938) 225 Iowa 404, 280 N. W. 587;

Ahern v. *Mudelman* (1940) 374 Ill. 237, 29 N. E. (2d) 268.

3. *The portion of the Sales Tax Act providing for the taxation of rentals is designed to close a loophole, not to make service taxable, and is subordinate to and*

controlled by the provision limiting the tax to "retail sales of tangible personal property."

The provision of the Sales Tax Act under which the Tax Commission has assessed the tax on the whole of the receipts from "original rental agreements" and from "re-writes" and "options" is as follows:

> "59-15-2 - Definitions - Scope - ***.
>
> (g) When right to continuous possession or use of any article of tangible personal property is granted under a lease or contract and such transfer of possession would be taxable if an outright sale were made, such lease or contract shall be considered the sale of such article and the tax shall be computed and paid by the vendor or lessor upon the rentals paid."

An "outright sale" is subject to tax only under the following provision:

> "59-15-4. Excise tax - Rate. - From and after the effective date of this act there is levied and there shall be collected and paid:
>
> (a) A tax upon every retail sale of tangible personal property made within the state of Utah equivalent to two per cent of the purchase price paid or charged, * * *."

The Sales Tax Act does not purport to tax rentals per se. What it does tax is the transfer of the right to continuous use or possession of tangible personal property when the transfer would be taxable *if an outright*

sale were made. The reason for having this rule at all is not to tax rentals, it is to collect a tax that is commensurate with what would be the *retail sales price of the property.* The idea is to keep people from evading the sales tax by leasing goods instead of selling them. This provision was designed to pick up such things as I. B. M. machine rentals and National Shoe Company machine rentals, where one *cannot* purchase the machines outright.

In the principal case, the signs can always be purchased by the customer, and the price to him is the "cash sales price", which is the cost of labor and materials used in the sign's manufacture, plus a 100% mark-up.

The Supreme Court of North Carolina, in *Watson Industries* v. *Shaw* 235 N. C. 203, 69 S. E. (2d) 505, construing that provision of their Sales Tax Act which extends the definition of "sale" to include "rentals" points up the purpose of that provision in unmistakeable language as follows:

> "But defendant leans heavily upon the part of the definition of 'sale' contained in G. S. Sec. 105-219 (c) which reads as follows: 'and shall further mean and include any bailment, loan, lease, *rental* or license to use or consume tangible personal property for a consideration paid * * * in which possession of said property passes to the bailee, borrower, lessee, or licensee.' This provision, howeverfi may not be lifted out of its context so as to universalize its meaning. A word

or phrase or clause or sentence may vary greatly in color and meaning according to the circumstances of its use. * * * It is axiomatic, therefore, that a provision in a statute must be construed as a part of the composite whole and must be accorded only that meaning which other modifying provisions and the clear intent purpose of the act will permit. It's meaning must sound a harmonious - not a discordant - note in the general tenor of the law.

The purpose of this extention of the ordinary meaning of the word 'sale' is apparent. It is intended to plug a possible loop hole in the statute by preventing a retailer from evading the provisions of the act by camouflaging a sale under the title of bailment, loan, lease, or like term when it is intended that in fact both the use and possession shall pass to hee bailee, borrower, lessee, or licensee. * *"* (Emphasis added.)

Both paragraphs of the above quotation are important to the rationale of this case. The first would indicate that the word "rentals" in the Utah Sales Tax Act must be construed in harmony with the portion of the Act limiting its application to the *"retail sale of tangible personal property"*, and the second would indicate that its purpose was to close a loop hole, not to expand the act surrepticiously to cover "services" because the charge for them is denominated "rentals" or not billed separately.

In *Paramount - Richard Theatres, Inc.*, vs. *State.* (1951) 256 Ala. 515, 55 So. (2d) 812, the court was con-

cerned with the effect on film rentals of a provision of the Use Tax Act defining "purchases" as including rentals. (In the Sales Tax Act the correlative provision is found in the definition of "sales", since the Use Tax is concerned with goods "purchased outside the state" and the Sales Tax Act is concerned with goods "sold" within the state.) The language of the court is as follows:

> "Much stress is laid upon the definition of subdivision (i) of Section 787 supra, which is as follows: '(i) The term 'purchase' means acquired for a consideration, whether such acquisition was affected by a transfer of title, or of possession, or of both, or a license to use or consume; whether such transfer shall have been absolute or conditional, and by whatsoever means the same shall have been effected; and whether such consideration be a price or rental in money, or by way of exchange or barter.'
>
> *"This provision of the Use Tax Act was obviously intended to prevent evasions of the act where there is an actual sale of tangible personal property. It was designed to prevent camouflaging an actual sale by designating it as a lease, license or rental and was not intended to include a bona fide rental of tangible personal property.* * * *" (Emphasis added.)

By citing the above cases the plaintiffs do not intend to argue that no part of the sign rentals charged in the original lease period are subject to sales tax. The point is that the purpose of the "rental" provisions in the Sales Tax Act was to close a loop hole and was not to expand

the act to cover maintenance and repair service just because the charge for that service is lumped together with the charge for the sign (the "cash sales price") under the designation "rental".

POINT II

THE TAX COMMISSION ERRED IN HOLDING THE RECEIPTS FROM "OPTIONS" AND "RE-WRITES" TO BE SUBJECT TO SALES TAX BECAUSE THOSE RECEIPTS ARE FROM THE SALE OF NON-TAXABLE MAINTENANCE AND REPAIR SERVICE, AND THE TAX COMMISSION HAS STIPULATED THAT THIS IS THE PURPOSE OF THOSE CHARGES.

When the term of the original rental agreement expires the company gives the customer an opportunity to continue to use and possess the sign involved if he will pay for its maintenance and repair. If the customer desires to do this, exactly the same rental agreement form is used as is used for the original period with but one substantial change, the monthly charge under the contract is just one-half (½) of the monthly charge under the orignal agreement. This new contract is called a "re-write".

Very often it is a few months between the expiration of the original rental agreement and the execution of the "re-write", or, in the alternative, the return of the sign. For this period the charge made is the same as for the "re-write," i.e., 50% of the original monthly

charge. This income is termed "option income" because it concerns the period when the customer has the option to "re-write". Option income should be treated, for sales tax purposes, the same as "re-writes".

By stipulation it is agreed that the income from re-writes is 37% of the total income from sign rentals. Though not specifically set out, it is believed this 37% figure includes "option income" as well and is, therefore, accurate for this whole category. It is apparent that the treatment of this type of transaction is of substantial importance to the taxpayer.

The Stipulation of Facts set forth the nature of re-writes in unmistakeable terms as follows:

> "12. If the customer, at the end of the original rental period, desires to continue to use the sign, a maintenance agreement is executed for a new term, on the basis of 50% of the original monthly charge. The agreements are on the same form as the original rentals and are termed "re-writes" on the books of the company.
>
> "17. During the re-write period, because of the increased age of the sign, the cost of maintaining the same is greater than the maintenance expense during the original rental period. The rental during that re-write period is for the purpose of compensating the company for maintaining and repairing the sign which includes the parts and materials, together with a reasonable profit.

"18. The entire cost of any signs placed with the customer under a rental agreement is amortized over the period of the original term of that agreement so that, at the expiration of the original lease period the sign is completely written off as an asset of the company. At that time the company eliminates from the contract price for the rental of the sign that portion of the rental which is attributed to recovering the cash sale price and re-writes the contract at a price approximately equal to what would be charged for the service and maintenance of the sign, were it the property of the customer."

In the re-write or option period there remains the element of "transfer of possession or use," normally a taxable transaction. The thing that is eliminated is the *charge* for that "transfer of possession or use." Because the lessee has fully paid, in the eyes of the company which owns the sign, the price of the sign, the company reduces its charge by one-half and thereafter only charges for maintaining and repairing the sign. Stipulation 12 above sets this forth unequivocally.

There must be (1) *a sale or transfer of use of tangible property* and (2) *a purchase price charged* before any sales tax liability accrues. In the re-write period, since no charge is made for the transfer of possession or use, the tax thereon is zero.

In its order the Tax Commission ruled that, as to maintenance agreements, the sales tax should be two per cent of the cost to the company of the materials used in

the maintenance and repair thereunder. The Tax Commission has stipulated that a re-write is a "maintenance agreement" executed on the same form of contract as the original rental agreements. (See Stipulation 12 above.) It follows that the sales tax relative to re-writes should be 2% of the cost of the materials used in maintaining and repairing the signs subject to re-write agreements.

POINT III

THE TAX COMMISSION ERRED IN HOLDING THE RECEIPTS FROM "MAINTENANCE CONTRACTS" AND FROM "REPAIR SALES" TO BE SUBJECT TO DIFFERENT MEASURES OF SALES TAX BECAUSE THE TRANSACTIONS ARE EXACTLY THE SAME IN EVERY PERTINENT RESPECT AND THE TAX COMMISSION STIPULATED THAT THEY SHOULD BE TAXED THE SAME.

The Stipulation of Facts states:

> "6. *Repair sales* are the billings for the repair, service and maintenance of signs owned by other persons and not subject to a 'maintenance agreement.' A customer calls in a request for service, the company's personnel and equipment go out and repair the sign, using what material is necessary, and the customer is invoiced for a lump sum charge. Labor and materials are not billed separately, but cost records are kept by the company. The cost of materials used in repair sales was a minor part of the total billings for repair sales for the period covered by the audit. It is agreed that the fair sales price of those materials is cost plus a 100% markup.

"7. *Maintenance agreements* are executed on the form received in evidence as Exhibit "C". Under those agreements the company agrees to maintain and repair a sign owned by the customer for a fixed monthly fee payable for a fixed period, usually 36 months.

It is agreed that the proper measure of the tax to be charged for the materials used in maintaining and repairing signs under maintenance agreements should be the same as is charged for those materials used under repair sales." (Emphasis added.)

The order of the Tax Commission so far as it relates to this subject, is as follows:

"1. That the measure of sales tax on parts and materials used in repair sales during the period from July 1, 1950 to June 30, 1953 shall be 2% of the fair selling price of the parts and materials used if separately stated on the bill to the customer, and, if not separately stated, 2% of the total billing.

2. That the measure of sales tax on parts and materials used in fulfillment of maintenance agreements during the period from July 1, 1950 to June 30, 1953 shall be 2% of the cost to the company of the parts and materials used.

* * *

4. That the deficiency against Young Electric Sign Co., Inc. in the amount of $1,161.20 for the period from July 1, 1950 to June 30, 1953, together with interest on the principal at the rate of 6%

per annum from October 7, 1953 until paid, and the deficiency against Young Electric Sign Company in the amount of $3,029.91 for the period July 1, 1950 to June 30, 1953, together with interest on the principal at the rate of 6% per annum October 7, 1953 until paid, be and are hereby assessed and sustained."

The portion of paragraph 1. of the Order stating that the measure of sales tax on parts and materials used in repair sales shall be 2% of the fair selling price if separately stated on the bill to the customer is pure surplusage, for the Stipulation of Facts states that the parts and materials are *never* billed separately. The effective portion of that order would be the portion which states that the measure of the sales tax on the parts and materials used in repair sales is 2% of the *totaling billing*. This imposes a sales tax of 33 1/3% of the cost of the materials and parts incorporated into a repair job, the costs of those parts and materials being but 6% of the total billing for the repair job. (The *total billing* is 16⅔ times the *cost of materials*. 16 2/3 times the sales tax is 33 1/3%.) This is the first of the three conflicting and mutually exclusive provisions in the Tax Commission's Order.

Paragraph 2 of the Order states that the proper measure of sales tax on the parts and materials used in fulfillment of "maintenance agreements" shall be 2% of the *cost* to the company of the parts and materials used. This clearly applies a different standard than that used as the measure of sales tax on parts and materials used

in repair sales despite the above stipulation that the standard should be the same. The only distinction between the work done under the two different arrangements, that is, "repair sales" and "maintenance agreements" is that the first is billed job by job as the work is done whereas the second is paid for by the customer at the rate of so much a month for a given period, usually thirty-six months, regardless of how much repair work is required during that period. *Under the first portion of its order the Commission has assessed a tax which is 16⅔ times the amount of the tax imposed under the second paragraph of its order on items which it has stipulated should be taxed the same.*

The third conflicting theory approved and adopted for these same transactions in the Order of the Tax Commission is incorporated in paragraph 4 thereof. That paragraph states that the deficiency as assessed by the auditor is "*hereby assessed and sustained.*"

Sales tax was imposed on "repair sales" by that deficiency assessment at a rate equal to 2% of the cost of the material and parts used therein plus a 100% markup. Cost plus 100% has been stipulated to be the fair sales price of those parts and materials. The tax thus assessed is *twice* the amount of the tax assessed under the provisions paragraph 2 of the order above.

Since the Tax Commission is bound by its stipulation it necessarily follows that the measure of sales tax

on "repair sales" and "maintenance contracts" must be the same, and cannot be as the Order of the Tax Commission has assessed it. One order reaching three clearly different and mutually exclusive results from the same set of facts must be erroneous and should, therefore, be reversed.

The plaintiffs believe the Tax Commission was correct in paragraph 2 of its order above wherein it assessed the sales tax on parts and materials used in the fulfillment of maintenance agreements at 2% of the cost to the company of the parts and materials used. Applying this standard to repair sales would result in the taxation of the parts and materials used in those sales at 2% of their cost and would exclude from sales tax the portion of the charge made for repair and maintenance service. The reasons and authorities sustaining this result are set forth under the discussion of the following two points.

POINT IV

MATERIALS USED BY THE COMPANY IN "REPAIR SALES" SHOULD BE TAXED AT THE RATE OF TWO PER CENT OF THE COST OF THOSE MATERIALS TO THE COMPANY AS WAS DONE WITH MATERIALS USED IN "MAINTENANCE CONTRACTS."

The company performs different functions for different categories of customers. It manufactures and sells signs and sign parts. It manufactures and rents signs. It maintains signs for other persons under main-

tenance contracts, and it repairs the signs of other persons when requested to make a service call. These service calls to repair other peoples' signs are referred to in the audit as "repair sales".

This point is concerned only with the question of how the materials which are used by the company in the course of servicing and maintaining signs owned by other persons should be taxed. The facts pertinent to this are found in the stipulation of facts and in the audit report of the State Tax Commission. The pertinent stipulations are set forth under the next preceding point at pages 32-33 of the brief. They define "repair sales" and "maintenance contracts" and state that the parts and materials used in each should be taxed the same. In its order the Tax Commission taxed the materials used in "maintenance contracts" at 2% of their cost and the purpose of this point is to affirm that conclusion on their part and show that it should apply to "repair sales" as well. This shouldn't ordinarily be necessary since the Tax Commission has already so stipulated, but, in view of the confusion in their order as discussed in the preceding point and of the fact that the Tax Commission has seen fit to ignore its signed stipulation, the following discussion is offered.

The audit report of the Young Electric Sign Company shows that total repair sales for the period of the audit were $244,986.01 and that the cost of the materials used in those repair sales was $14, 698.75. This shows

Salt Lake operation. The Salt Lake plant made eighty-seven per cent (87%) of the repair sales involved in this audit.

The statutes concerned in this problem are as follows:

> "59-15-4. Excise tax — Rate. — From and after the effective date of this act there is levied and there shall be collected and paid:
>
> "(a) A tax upon every retail sale of tangible personal property made within the state of Utah equivalent to two per cent of the purchase price paid or charged * * *."
>
> "59-15-2. * * * (c) The term 'wholesaler' means a person doing a regularly organized wholesale or jobbing business, and known to the trade as such and selling to retail merchants, jobbers, dealers or other wholesalers, for the purpose of resale;
>
> "(d) The term 'wholesale sale' means a sale of tangible personal property by wholesalers to retail merchants, jobbers, dealers or other wholesalers for resale and does not include a sale by wholesalers to users or consumers, not for resale;
>
> "(e) The term 'retailer' means a person doing a regularly organized business in tangible personal property, known to the trade and public as such and selling only to the user or consumer and not for resale. 'Retail sale' includes all sales

made within the state of tangible personal property except wholesale sales."

The State Tax Commission has promulgated a regulation interpreting the application of this statute to sales of materials to repairmen and servicemen. That regulation is as follows:

> "59. *Sales of materials to repairmen and servicemen.* — All sales of materials and supplies to persons engaged in altering or repairing personal property of others, where the alteration or repair of such property is essentially a service and the furnishing of materials and supplies is merely incidental to the service rendered, are taxable. For example, sales of materials are subject to tax when made to persons engaged in repairing shoes, tubes, clothing, furs, fishing rods.
>
> "Sales of materials or supplies to repairmen where the furnishing of such materials is more than merely incidental to the repairman's business are wholesale sales and exempt from tax. For example, sales of materials are not taxable when made to persons engaged in repairing automobiles, bicycles, radios, eye glasses, typewriters and other business machines, tires by recapping, and all other purposes when specific parts or materials are separately billed. Vendors making sales to such repairmen are required to obtain resale certificates as set forth in regulation 23 of the sales tax regulations."

It would appear that the State Tax Commission considers the furnishing of materials and supplies to be merely incidental to the service rendered in the repair of

shoes, tubes, clothing, furs and fishing rods. It would seem further that the measure of the sales tax in instances where the furnishing of the materials is merely incidental to the service is two per cent of the *cost* of the material to the repairman or serviceman. In instances where the furnishing of such material is more than merely incidental to the repairman's business the measure of the tax would be two per cent of the sales price of the material. In the principal case it is agreed that the fair sale price of the material involved is exactly twice the cost of that material to the company.

The problem involved in this portion of the principal case has been considered by the Supreme Court of Utah in *Western Leather and Finding Company v. State Tax Commission,* 87 U. 227, 48 P. (2d) 526. The Western Leather and Finding Company sold leather and shoe findings to shoe repairers operating in Utah. The shoe repairers did not make a separate charge for materials used and labor performed in the repairing of shoes and, in the average repair job, the cost of materials was about thirty per cent and the labor seventy per cent of the total charge. The specific question involved was whether the sale of the leather and shoe findings to shoe repairers was a "wholesale sale" or a "retail sale" within the meaning of the Sales Tax Act. The Tax Commission held that the Western Leather and Finding Company was liable for the payment of sales tax upon the leather and shoe findings sold to shoe repairers and the Supreme Court reversed that holding. The majority opinion based

its holding on the proposition that the ultimate consumer and user of the leather and shoe findings was the person who wore the shoes after they were repaired, that the shoe repairman was, in fact, a retailer of shoe repair materials and as such was obligated to collect and pay the tax. The fact that the shoe repairer did not make separate charges for labor and material was held to be immaterial.

Mr. Justice Wolfe's concurring opinion is the portion of the case wherein the rationale adopted by the tax commission in its regulation, to-wit, the distinction between whether the furnishing of materials is "merely incidental" to the service rendered in a repair sale or is "more than incidental," is discussed. After setting forth the statutes involved (the same statutes in this discussion above), Mr. Justice Wolfe has the following to say:

> "It can be seen from an examination of these sections that they rather contemplated articles which were sold through wholesalers to persons for resale to those who actually used them, and contemplated a retailer as someone who sold goods from stock as such and not the person who furnishes material in connection with repairs.
>
> "The problem can be best approached by assuming extreme cases on both ends of the gamut. When a barber shaves a person, the lather and soap and soothing lotion which go upon the customer are mere incidentals as compared to the service performed. It is likewise true of shoe shiners. These illustrate cases on one end of the gamut. Where a merchant sells readymade clothing and in connection therewith does alterations and per-

haps furnishes materials, such as a small piece of cloth or thread, we have a case in which the services are merely incidental to the sale. Other cases lie in between. The automobile repair shop furnishes parts as well as services. The parts may at times amount to more than the services and other times vice versa. Some trades have long customarily separated their charges for services and parts. The automobile repair trade is an example. There it is quite easy to make the separation because the parts are usually very definite. In the shoe repairing industry, on the other hand, the practice has been just the opposite. A gross charge is made without separation. Indeed, it might be difficult to make the separation in this trade because of the difficulty of determining just how much leather cut from a larger piece goes into each job.

"The commission is entitled to promulgate rules and regulations for the practical and proper administration of the act. Such cannot be against the teeth of the law. They can serve to fill up the details as long as they do not run counter to the express will of the Legislature. If the ruling requiring the leather and findings companies to collect the tax from the repairmen is contrary to the method of assessment and collection of the sales tax laid down by the Legislature, such regulation is invalid. If, on the other hand, there is a reasonable question about it or it is certain that it is harmonious with the provisions laid down by the Legislature then it should be upheld. Considerations of practicality may be taken into account. Where two constructions of an act giving administrative powers to a commission are permissible, that construction which comports more practically with the actual execution and administration

of the law by the commission should be adopted. The commission has the duty of executing and administering the law. The practical difficulties in accomplishing that should be recognized by the courts. The court, sitting purely in an atmosphere of abstract argument and reasoning without recognizing the realities of the situation under which the commission works, might adhere to a strictly logical construction of the provisions of an act which would make it entirely unworkable. From the examples on either end of the gamut given above we can see that certain practical concessions must be made by the commission in the construction of the law. It could not possibly require a separation of materials used in connection with services of barbers, shoe shiners, or shoe repairment where they, for instance, used only shaving soap and lotion (although these are really consumed), a piece of thread to sew up a shoe, or polish to shine the shoes (also really consumed). Likewise, it is the same with tailors repairing clothes. Also with some materials furnished by cleaners and dyers (perhaps also consumed). Theoretically and perhaps logically those service industries may effect a sale to the patron of tangible articles which they use in connection with their services. If so, the value of the articles sold and contributed in connection with the services are so incidental and so proportionately small as compared to the value of the services that for practical reasons they cannot be considered as a sale. On the other hand, when an article is sold and the servicing of the same incidental to the sale is such a small part of the price of the whole, such value of the services cannot be subtracted from the sale price. Where to draw the line is questionable, but unless this court is convinced that the commission erred in drawing the line where it did,

this court should not interfere with or upset its rulings.

> "It is stipulated that the value of the property which is applied to the repair of the shoes amounts to about 30 per cent of the entire price. I concur with the prevailing opinion on the ground that the amount of goods which goes into a shoe repair job as compared with the value of the whole job is apparently not a mere incidental of the repair job. It appears to be a very substantial part of the cost of the whole job. * * *"

The above case was decided in 1935 and to this very day the tax commission in its regulation provides that in a shoe repair job, the furnishing of materials and supplies is "merely incidental." It is apparent from this that the tax commission believes that in the instance of shoe repairmen, where the cost of materials furnished is thirty per cent of the whole charge for the repair job, the furnishing of the materials is "incidental."

Another of the examples of where the furnishing of the materials is "merely incidental" has been dealt with by the Supreme Court of the State of Illinois in *Mahon v. Nudelman* (1941) 377 Ill. 331, 36 N.E. (2d) 550. That case involved the repairing and restyling of fur garments for customers with the repairman furnishing the fur pieces or strips and linings needed to complete the work. No separation was made in the billing between materials and services. It was determined that an average of fifteen per cent (15%) of the charge for the repair work was for materials whereas the balance was for labor, overhead, and profit. In that case the court took

the view that such persons were engaged in the repair business rather than the retail sales business so far as the sales of materials were concerned and that such sales were merely an incident to the repair business.

The reasoning used by Mr. Justice Wolfe, and by the Illinois Supreme Court, and apparently by the Tax Commission is that where the transaction is essentially a sale of materials, with some service thrown in, the repairman is himself the person making a retail sale and is the person who must collect and pay the tax. Where the transaction is, in fact, essentially the rendering of service with the incidental use of some material, the repairman is the "ultimate consumer and user" of the material, is not making a retail sale and need not collect and pay over the sales tax on the materials furnished in the repair job. He must, of course, pay sales tax on the materials when he purchases them.

We have, then, a situation where the State Tax Commission believes the furnishing of materials, the cost of which is thirty per cent of the total price of the repair job, is "merely incidental," where the Supreme Court of Illinois has held (and the State Tax Commission of Utah apparently has adopted by regulation) that the materials used in the repair of furs, the material cost being fifteen per cent of the whole price of the repair job, are "merely incidental." And we have, in the instant case, the decision of the State Tax Commission that, where the cost of the materials furnished is only six per cent of the whole charge for the repair job, the sale of materials is not "merely incidental" to the service.

The Commissioners of the District of Columbia have, by regulation, provided that the sale of tangible personal property in connection with personal service transactions is an "inconsequential element" where the price of the tangible personal property is less than ten per cent of the amount charged for the services rendered. This was discussed apparently with approval by the U.S. Court of Appeals District of Columbia Circuit (presided over by the late Honorable Harold M. Stephens) in *Washington Times-Herald, Inc. v. District of Columbia*, (1954) 213 F. 2d 23, on page 24 as follows:

> "Section 47-2701, Sub. 1 (b) (3) of the Code exempts from sales and use taxes 'Professional, insurance, or personal service transactions which involved sales as inconsequential elements for which no separate charges are made.' An implementing Regulation provides that a sale is an 'inconsequential element' where the price of the tangible personal property is less than ten per cent of the amount charged for the services rendered. * * *" (Citing Section 202 (b) of the Regulations pertaining to Sales and Use Taxes, promulgated July 12, 1949, by the Commissioners of the District of Columbia.)

The standard adopted by the Tax Commission of Utah that the sale be "merely incidental" to the service, would appear to be less stringent than the "inconsequential" standard adopted by the District of Columbia.

There is a discussion at 11 A.L.R. (2d) 926 of when repairmen must pay sales tax on the materials they pur-

chase. This is exactly the same question as is in the principal case, with the plaintiffs contending *they* should pay tax on the materials used in repair sales.

The Supreme Court of Georgia holds that in determining whether tangible personal property involved in a personal service transaction in which no separate charge is made for materials is an "inconsequential element" of the service transaction within the Use and Sales Tax Act, *actual cost or monetary value of the materials used is not determinative* and the *main consideration is the purpose of the customer,* that is, whether he is primarily interested in buying services rather than materials. *Craig-Tourial Leather Co.* v. *Reynolds,* 87 Ga. App. 360; 73 SE (2d) 749. They hold that even though the cost of material used in a shoe repair sale is 50% of the charge and the cost of the repair labor is 50%, the sale of the materials is inconsequential, because the customer "primarily wishes to buy the skilled services of a shoe repairman because such services cannot be performed by the customer because he lacks the equipment, time, or skill required. Under such circumstances, the sale of various grades or qualities of materials by the shoe repairman is really *incidental to* and but a means of rendering the services which his customer wants." The shoe repairman had to pay sales tax on the leather when he purchased it and did not charge his customers tax on the repair job. This is in accord with the view of the Tax Commission of Utah as adopted in Regulation 59, though

at variance with the Western Leather and Finding Co. case, supra.

By this standard, where, as in the principal case, the service of skilled electrical sign repairmen is the item constituting almost all of the charge on a repair sale it can be presumed that the customers are primarily seeking the skills and services. Otherwise they would simply buy the materials direct and save 94% of their repair bills.

POINT V

THE TAX COMMISSION ERRED IN HOLDING THE WHOLE RECEIPTS FROM "REPAIR SALES" TO BE SUBJECT TO SALES TAX UNLESS THE MATERIALS ARE BILLED SEPARATELY, BECAUSE THERE IS NO AUTHORITY IN THE SALES TAX ACT FOR THE TAXING OF MAINTENANCE AND REPAIR SERVICE AND THE TAX COMMISSION CANNOT, BY REGULATION, RENDER THAT TAXABLE WHICH THE LEGISLATURE HAS NOT SUBJECTED TO TAX.

The proposition that service, including maintenance and repair service, is not subject to sales tax has been discussed at length in Point I of this brief. The conclusion reached under that point was that said services are not subject to sales tax.

The authority of the State Tax Commission under the Sales Tax Act is as follows:

"59-15-20. *Administration vested in Tax Commission.* — The administration of this act is vested in and shall be exercised by the state tax commission which may prescribe forms and rules and regulations in conformity with this act for the making of returns and for the ascertainment, assessment and collection of the taxes imposed hereunder."

Early in the life of the Sales Tax Act the Supreme Court of Utah was called on to discuss the powers of the State Tax Commission under the above provision. In *Western Leather and Finding Co. v. State Tax Commission of Utah,* supra, Chief Justice Elias Hansen, speaking for the majority of the court, set forth the following rules:

> "The power vested in the commission to prescribe rules and regulations for making returns for ascertaining assessment and collection of the tax imposed by the act does not vest in the commission any discretion whatsoever in the matter of requiring the payment of a sales tax by any one other than such as are designated in the act. It is true that an administrative body within prescribed limits, and when authorized by the lawmaking power, may make rules and regulations calculated to carry into effect the expressed legislative intention. Under our State Constitution the legislative power of the state shall be vested:
>
> '1. In a Senate and House of Representatives which shall be designated the Legislature of the State of Utah.
>
> '2. In the people of the State of Utah, as hereinafter stated.' Constitution of Utah, art. 6, §1.

"The Legislature is not permitted to abdicate or transfer to others the essential legislative function with which it is thus vested. The imposition of a tax and the designation of those who must pay the same is such an essential legislative function as may not be transferred to others. The act under review, however, is not open to the objection that the Legislature by the act attempted to transfer its authority to levy taxes and designate the persons who are required to pay the same to the State Tax Commission. The commission is empowered merely to make rules and regulations, etc., in conformity with the act." * * *

"It is urged on behalf of the commission that shoe repairers should not be requested to pay a sales tax on the materials used to repair shoes because there is a custom among them not to make separate charges for services rendered and for materials furnished in repairing shoes. The act does not make such fact, nor the fact, if it be a fact, that it is difficult for shoe repairers to make separate charges for labor performed and materials furnished in repairing shoes, the basis for shifting the duty of collecting and paying the sales tax on to others."

In *Utah Concrete Products Corp. v. State Tax Commission,* 101 U. 513, 125 P. (2d) 408, at page 412, the Utah Supreme Court said in relation to the power of the Tax Commission under the Sales Tax Act:

"Governmental agencies cannot deprive the courts of their judicial functions nor can the agencies extend the operation of the statute by administrative regulations."

A case of interest in regard to the power of the Tax Commission and the validity of a regulation which makes "method of billing" a determinative factor in the sales tax field is *Blome v. Ames,* 365 Ill. 456, 6 N.E. (2d) 841, 111 A.L.R. 940. Rule 6 issued by the Illinois Department of Finance provided, in relation to contractors, that where the cost of materials and supplies furnished is computed separate from the labor, either in the contract or billing to the owner, sales tax should be computed on the gross receipts for materials. If no separation is made either in the contract or billing, the computation is on the lump sum paid the contractor or subcontractor or for work and materials. This regulation was held invalid and the language of the court was as follows:

> "However, appellants are correct in their contention that the appellee, director of finance, was without power to control the appellants' method of billing to or the form of their contracts with owners. The statute provides the method of computing the occupational tax where the taxpayer fails, or refuses to keep books and make reports, and only such penalties as are provided by the statute can be imposed upon the taxpayer.
>
> "When sales to the owners are of fabricated materials or equipment, the department may compute the tax on the price of such materials so fabricated, but when materials are furnished to be used to erect or repair a structure, the service involved in such erection or repair does not constitute tangible personal property, or the sale thereof."

Blome v. Ames, supra, was later overruled on the question of whether the contractor himself was the ultimate consumer of the materials used in constructing buildings, but not on the question of the validity of a regulation such as Rule 6 above.

The importance of the reasoning of the Illinois court to the instant case is (1) it affirms the proposition that neither the form of the billing nor the form of the contract is controlling as against the "substance" of the transaction, (2) as to "repair sales," the portion of Regulation 59 that applies sales tax to the whole billing for the repair job unless the parts are billed separately is invalid, (3) the taxation of maintenance and repair service simply because the charge for it is denominated a "rental" would amount to the assessment by the Tax Commission of a penalty not authorized by law.

It might well be argued that plain common sense requires that there be some reasonable latitude allowed the Tax Commission where the "service" element is small and cannot be separated from the sale or rental of the tangible personal property, as Justice Wolfe pointed out in his concurring opinion in the Western Leather & Finding Co. case, supra. Essentially what he was doing was invoking the *de minimus* rule in this field. However, that reasoning could not be invoked where more than 50% of the rental charge is for the sale of maintenance and repair service. And it certainly would have no application where the division of the "retail sales price of the

sign" portion of the rental (the cash sales price) from the "service and maintenance price" portion of the rental can be readily made from the books of the company, as in the instant case.

To enable "services" to be subjected to sales tax would require an act of the Legislature. There is nothing in the Sales Tax Act as it is presently constituted that gives the Tax Commission the authority to assess and collect sales tax on charges made for the services of skilled maintenance and repairmen simply because the charge for those services, though readily ascertainable from the books of the company, is not separated in the rental contract or the repair bill.

To allow the Commission to make services taxable, as the Illinois court pointed out in *Blome v. Ames* above, would be to give them the power to control the contracts and billings of the business people of this state by the simple expedient of penalizing with additional tax the method of billing or form of contract which the Tax Commission disliked.

POINT VI

WHETHER A GIVEN SALE IS SUBJECT TO SALES TAX IN UTAH SHOULD BE DETERMINED BY THE SUBSTANCE OF THE SALE, NOT BY ITS FORM OR MANNER OF BILLING.

The Legislature has designated a type of transaction which is subject to a 2% tax, to-wit, the retail sale

of tangible personal property. It has further said the tax may not be escaped by disguising the sale as a lease or contract, when the substance of the transaction is the transfer of continuous possession or use. The statute is couched in terms of the essential nature, the substance, of the transaction, and whether a transaction is subject to sales tax should be determined on the basis of the substance rather than the form of the transaction.

Surely one could not escape the sales tax by calling his charges for the sale of tangible personal property "friendship payments" or "involuntary gratuities," or any other name. The court would immediately look behind the term used in the billing and say "what is the essential nature, the substance, of the transaction?" Is there any better reason, then, why mere terminology, to-wit, "rentals," should bring a transaction *within* the scope of the act than that mere terminology should take a transaction *outside* the scope of the act?

In *Whitehill Sand & Gravel Co. v. State Tax Commission,* 106 U. 469, 150 P. (2d) 370, this court dealt with sales of gravel upon which there was no separation of the price charged for the gravel and the transportation charge. All were billed at "X yards of gravel at $1.70 per yard." The court instructed the Tax Commission to look behind the *billing* to the *substance* of the transaction and, despite the fact that the sale price and transportation price were lumped together on the invoice, to ascertain whether, in fact, the sale of gravel took place

at the pit before transportation or at the place of delivery, after transportation.

In the instant case the plaintiffs believe the liability or non-liability for sales tax should be determined by the *substance* of the transaction, whether it was a sale of maintenance and repair service or a sale (or rental in lieu of sale) of tangible personal property. The portion of the original rental which was the charge for maintenance and repair service (51.26%) should not be subjected to tax and the portion of the original rental which was the charge for the transfer of use and possession of the sign (48.74%) should be subjected to tax. In the case ~~per cent (6%) of the total charge for those sales in the that the cost of materials used in repair sales was six~~ of re-writes and options, where the whole of the "rental" is for maintenance and repair, none of the charge is subject to sales tax.

POINT VII

TAXING STATUTES ARE TO BE STRICTLY CONSTRUED, AND, IN CASES OF DOUBT, ARE TO BE CONSTRUED MOST STRONGLY AGAINST THE GOVERNMENT AND IN FAVOR OF THE TAXPAYER.

That the rule that taxation statutes are strictly construed against the state and in favor of the taxpayer applies to the Sales Tax Act has already been decided in Utah. In *W. F. Jensen Candy Co. v. State Tax Commission*, 92 U. 493, 61 P. (2d) 629, at page 632, Justice Moffat, speaking for the court, pointed this out as follows:

"Having in mind the general rule that taxation statutes are strictly construed against the state and in favor of the taxpayer, the language of the statute permits the collection of the tax at the rate specified and no more. It is also recognized that no method or form of taxation has yet been devised that is absolutely equal and uniform. Salt Lake City v. Christensen Co., 34 Utah 38, 95 P. 523, 17 L.R.A. (N.S.) 898."

CONCLUSION

For the reasons set forth above the plaintiffs pray this court to vacate the order of the Tax Commission and instruct the Commission to make its assessment, or determine its refund, as the case may be, on the following basis:

1. All the receipts from outright sales of signs and sign parts are subject to sales tax, except for intercompany, interstate, exempt and wholesale sales.

2. 48.74% of the receipts from rental agreements on signs during the original period of the agreement are subject to sales tax.

3. None of the receipts from re-writes and options is subject to sales tax.

4. None of the receipts from maintenance contracts and repair sales are subject to sales tax.

5. Sales tax shall be paid on all parts and materials used in maintaining and repairing signs under original rental agreements, options, re-writes, maintenance contracts and repair sales, at 2% of the cost of those parts and materials to the plaintiffs.

Respectfully submitted,

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